No. 22352

IN THE

United States Court of Appeals
For the Ninth Circuit

Peter Pan Seafoods, Inc., a Washington corporation,
Appellant,

v.

The United States of America,
Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

Honorable George H. Boldt,
United States District Judge

OPENING BRIEF OF APPELLANT

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STATEMENT OF JURISDICTION

This is a civil action by appellant, Peter Pan Seafoods, Inc., a Washington corporation, against the appellee, The United States of America, to recover income taxes and interest in the total amount of $286,886.26, erroneously assessed and collected for appellant's taxable years ended March 31, 1960, and March 31, 1961 (R. 1-77, 109, 125). Appellant's Complaint was filed in the United States District Court for the Western District of Washington, Southern Division, on February 17, 1965 (R. 1). That court had jurisdiction of the action under and by virtue of 28 U.S.C.A. Section 1346(a)(1).

Following trial of the case before the Honorable George H. Boldt, sitting without a jury, a Judgment of dismissal was entered on August 7, 1967 (R. 128) from which appellant appealed to this court on October 4, 1967 (R. 129). This court has jurisdiction to review the Judgment in question under and by virtue of 28 U.S.C.A. Sections 1291 and 1294(1).

STATEMENT OF THE CASE

The Questions Involved

This is an action by appellant, Peter Pan Seafoods, Inc., hereinafter referred to as appellant taxpayer, to recover income taxes and interest in the total amount of $286,886.26, assessed and collected by the Commissioner of Internal Revenue for the taxable years ended March 31, 1960, and March 31, 1961, as a result of the recomputation by the Commissioner of net operating losses carried forward from prior years. The transactions upon which the Commissioner bases his recomputation of said net operating losses occurred in the tax year ended March 31, 1957 and involved the acquisition by another Washington corporation, The Ajax Company, of two mortgage notes previously executed and issued by appellant taxpayer.

It was the initial contention of appellee that these two mortgage notes were in substance acquired by appellant taxpayer, which thereby realized income as the result of cancellation of indebtedness. During the trial in the court below, appellee put forth a further contention based on

Section 269(a) of the Internal Revenue Code of 1954.[1]

The transactions in question may be briefly summarized as follows:

In 1950, appellant taxpayer executed two mortgage notes in the total amount of $1,668,432. Six years later, in 1956, it appeared that these mortgage notes might be purchased at a substantial discount. However, it was determined by the president of appellant taxpayer, Mr. Nick Bez, that it was not feasible for appellant taxpayer to attempt to acquire them, because, in his opinion, the income tax liability which would be incurred as a result of the acquisition, when added to any possible purchase price, would result in an overall cost for the notes which would be prohibitive under the circumstances as they then existed (Admitted Facts X, XIII, XIV, R., 86-88, 125).

Mr. Bez, who was also a substantial stockholder of appellant taxpayer, then began to explore the possibility of joining with other stockholders to purchase the notes. To this end, he caused The Ajax Company to be organized and solicited other stockholders of appellant tax-

(1) Sec. 269(a) of the Int. Rev. Code of 1954 (prior to 1963 amendment), insofar as claimed by appellee to be applicable, provides as follows:

> "(a) In General. —If—
>
> (1) any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or
>
> (2) * * *
>
> and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 per cent of the total combined voting power of all classes of stock entitled to vote or at least 50 per cent of the total value of shares of all classes of stock of the corporation."

payer for subscriptions for stock and notes to be issued by The Ajax Company (Admitted Facts XV, XVI, R. 88, 89, 125).

The larger number, but not all, of the stockholders of appellant taxpayer subscribed for Ajax stock and notes, and with the funds so obtained and the proceeds of a bank loan, The Ajax Company negotiated for and acquired the mortgage notes for an aggregate net purchase price of $774,228.00. Simultaneously with their acquisition, the mortgage notes were pledged by The Ajax Company to the bank as collateral for its bank loan. After the acquisition of the mortgage notes, payments of interest and principal thereon were made by appellant taxpayer to The Ajax Company. From the date of incorporation of The Ajax Company until it acquired all of the stock of appellant taxpayer in 1959, The Ajax Company did not engage in any business activity other than the acquisition of said mortgage notes and the negotiations in connection therewith, and during said period, said mortgage notes were its only assets, except for a small amount of cash (Admitted Facts XVII thru XXXII, and XL, with related Exhibits, R. 89-95, 99).

It has been stipulated by the parties that the income tax liability of the appellant taxpayer for its taxable years ended March 31, 1960 and March 31, 1961 is correctly stated in the Commissioner's Notice of Deficiency (Ex. A-1), except insofar as the same may be affected by the court's decision on the issue of law herein[2] (Stipulation IV, R. 104).

(2) Net operating loss carrybacks from later years are also excepted since the Government concedes that a decision in this case should not bar taxpayer from the benefit of carrybacks which may develop after the Commissioner's Notice of Deficiency.

The issue of law in this proceeding is stated in the Pre-Trial Order as follows:

> "The following is the issue of law to be determined by the Court: Whether or not, as a result of the transactions involved with reference to the said mortgage notes, Plaintiff [Appellant Taxpayer] realized taxable income in its taxable year ended March 31, 1957 from cancellation of indebtedness." (R. 104).

At the close of the case before the court below (but before argument), the Government put forth the further contention above mentioned based on Section 269(a)(1) of the Internal Revenue Code. This contention was asserted in a trial brief which was the first notice of it that appellant taxpayer received except for mention of it in a telephone conversation on the eve of trial (Transcript of Proceedings of February 10, 1967, pp. 37, 42).

The court below found as a fact that the primary, dominant and moving purpose for the formation of The Ajax Company was to avoid Federal income tax on the purchase of the mortgage notes (Finding of Fact No. 10, R. 127). On the basis of this finding, the court concluded that the negotiations for, and purchase and holding of, the mortgage notes (which was stipulated to be the only business activity of Ajax until it acquired all of the stock of appellant taxpayer in 1959) did not constitute a business for the purpose of applying the tax statutes because "escaping taxation is not 'business'", and consequently cannot be said to have any commercial or industrial purpose (R. 117).

The conclusions of law of the court below were that

1. The mortgage notes in question were in substance purchased by appellant taxpayer and should be so treated for purposes of determining Federal income tax liability

and that, accordingly, appellant taxpayer realized taxable income under Section 61(a)(12) of the Internal Revenue Code of 1954 upon the purchase of the notes at a discount; and

2. The net operating loss deductions claimed by appellant taxpayer are disallowed by Section 269(a) of the Code (R. 127).

It is the contention of appellant taxpayer that—

1. Appellant taxpayer was not under any legal or other compulsion to purchase its mortgage notes, and avoidance of the ruinous tax consequences of doing so was a legitimate reason for not purchasing them.

2. The stockholders of appellant taxpayer, or any group of them, had every right to purchase the notes for their own account, if the holders were willing to sell; and such stockholders had every right to organize and employ a separate corporation as the vehicle to accomplish such purchase. The Admitted Facts establish that this was what was done.

3. The motive of tax avoidance will not establish tax liability if the transaction does not do so without it.

4. The purchase of an indebtedness by the stockholders of the debtor corporation, or by a new corporation organized by such stockholders for that purpose, does not constitute an acquisition of the indebtedness by the debtor; and the motive of tax avoidance will not convert the transaction into a purchase of the indebtedness by the debtor corporation, in substance or otherwise.

5. Negotiations for and purchase of mortgage notes at a discount from unrelated third parties is a legitimate business activity with a clear commercial purpose, who-

ever the purchaser may be, and the motive of tax avoidance does not change its character in that respect; thus, the fact that the appellant taxpayer could have purchased the mortgage notes does not render the purchase by Ajax devoid of a commercial purpose, whatever tax avoidance motives may have been involved.

6. Any disregard of the corporate entity of Ajax leads only to its stockholders, not to appellant taxpayer.

7. Section 269(a)(1) cannot apply to the situation here involved because appellant taxpayer did not acquire control of Ajax, nor did Ajax acquire control of appellant taxpayer. The acquisition of such control is essential to the application of this section; and the fact that two corporations have the same, or largely the same, stockholders does not constitute control by one of them over the other within the meaning of this section.

8. Section 269(a)(1) cannot apply to the situation here involved for the additional and independent reason that appellant taxpayer did not secure the benefit of a deduction, credit or other allowance which it would not otherwise have enjoyed. On the contrary, the net operating loss deduction which respondent seeks to disallow is a deduction the benefit of which appellant taxpayer *would* otherwise have enjoyed.

Statement of Facts

As stated by the court below, the facts are largely admitted by both parties in the Pre-Trial Order (R. 112).

Appellant taxpayer is a Washington corporation engaged in the business of canning salmon in Alaska and dealing in domestic and foreign canned salmon packed by others (Admitted Fact XXXIV, R. 96).

On March 23, 1950, appellant taxpayer (the name of which was then P. E. Harris Company, Inc.) executed two mortgage notes in the total amount of $1,668,432 for the purchase of certain properties from P. E. Harris & Co., a corporation then in the process of liquidation (Admitted Fact X, R. 86).

Nothwithstanding the similarity of the names of the two corporations, there was no connection between their stockholders, except that two individuals were minor stockholders of both corporations (Admitted Fact XI, R. 86, 87).

In June, 1950, these mortgage notes were transferred by the payee to Seattle-First National Bank as Trustee for the former stockholders of the payee corporation; and said bank issued Certificates of Beneficial Interest to each of such former stockholders to evidence his interest under the trust. There were 68 beneficiaries under this trust, holding a total of 119,112 beneficial interests in all (Admitted Fact XII, R. 87; Ex. A-2).

Six years later, in 1956, it appeared that the mortgage notes might be acquired for an amount substantially less than the balance of the indebtedness evidenced thereby. In view of the possibility of acquiring the mortgage notes, Mr. Nick Bez, the president of appellant taxpayer, inquired of its legal and accounting advisors as to the Federal income tax consequences in the event appellant taxpayer were to acquire the notes. He was advised that any acquisition of said mortgage notes by appellant taxpayer at a substantial discount would result in the realization of taxable income in an amount equal to the discount. On the basis of this advice, Mr. Bez concluded that it would not be feasible for appellant taxpayer to attempt to acquire the mortgage notes because, in his opinion, the immediate income tax liability which would be incurred as a result of the acquisition, when added to any possible purchase price, would result in an overall cost for the notes which would be prohibitive under the circumstances as they then existed (Admitted Facts XIII, XIV, R. 87, 88).

Mr. Bez, who was also a substantial stockholder of appellant taxpayer, then began to explore the possibility of joining with other stockholders of appellant taxpayer for the purpose of attempting to purchase the mortgage notes. At this time, appellant taxpayer had outstanding 15,000 shares of stock and $700,000 in unsecured notes.[3] It had 27[4] stockholders residing in the states of Washington, California, Florida and other states. Ten of these stockholders held no notes. Three note holders held no stock. Mr. Bez, together with a corporation and a partnership[5] which he controlled owned approximately 25% of appellant taxpayer's stock and approximately 28% of

(3) These unsecured notes had initially been sold pro rata to purchasers of Appellant Taxpayer's stock in 1950, but, as a result of subsequent transfers of stock without notes, and of notes without stock, they were held during the period here involved, as shown by Exhibit SS.

(4) Rather than 29, as indicated by Exhibits S and SS, since the shares registered in the joint names of Calvert Corporation and Trans-Pacific Fishing & Packing Co. were owned by the partnership Peninsula Packers. See note (5). Also, John Earle Jardine and J. E. Jardine, deceased, were the same person.

(5) Trans-Pacific Fishing & Packing Co., a corporation, and Peninsula Packers, a partnership. The sole partners of the partnership Peninsula Packers were two corporations, Trans-Pacific Fishing & Packing Co., the stock of which was owned by Mr. Bez and his family, and Calvert Corporation, the stock of which was owned by members of the Calvert family who had been closely associated with Mr. Bez over a substantial period in various business enterprises relating to the salmon canning and fishing industry in Alaska and the Pacific Northwest (Admitted Fact XXXIII, R. 95, 96).

its unsecured notes, and thus controlled the largest single amount of appellant taxpayer's stock. However, no individual or group held clear control of appellant taxpayer (Admitted Facts XV, XXXII, XXXIII, R. 95, 96; Finding of Fact No. 6, R. 125; Exs. S, SS).

With the assistance of Mr. G. Hamilton Beasley (since deceased), who was also a stockholder, officer and director of appellant taxpayer, Mr. Bez caused The Ajax Company to be organized as a Washington corporation on May 21, 1956 for the purpose of attempting to purchase the mortgage notes. Thereafter, he and Beasley solicited powers of attorney from the other stockholders of appellant taxpayer to subscribe for shares of stock and five-year 6% notes of The Ajax Company. Twenty-two subscriptions for stock and notes of The Ajax Company were thus obtained for a total of 12,928 shares of stock and $129,300.52 in notes (Admitted Facts XVI, XXVII, R. 88, 93; Exs. B, C, R).

No stockholder influential in appellant taxpayer, either by virtue of an executive office or because of substantial stock ownership, declined to participate in the formation of Ajax; however, there were 17 stockholders of appellant taxpayer holding a total of 3,757.40 shares of appellant taxpayer's stock who did not subscribe for any stock or notes of Ajax. Nine of the subscribers for Ajax stock and notes owned no stock of appellant taxpayer. Two of these nine were holders of unsecured notes of appellant taxpayer, and the remaining seven held no stock or notes of appellant taxpayer (Finding of Fact No. 6, R. 125; Ex. SS).

Mr. G. Hamilton Beasley, the president of Ajax, was the largest single stockholder of appellant taxpayer, owning 2,856 shares. However, he subscribed for only 618 shares of Ajax (Finding of Fact No. 6, R. 126, Ex. SS).

Certain of the stockholders of each corporation who owned no stock in the other corporation were related in one way or another. Thus, Donald Royce (161 shares of appellant taxpayer) was a partner in William R. Staats Company (1,393 shares of Ajax), [Deposition of Wm. A. Hinckley, 12/7/66, p. 6]. Mr. Royce's wife, Mrs. Laura C. Royce, owned 200 shares of appellant taxpayer. Thos. J. Bannan (706 shares of Ajax) was the principal stockholder of Webster-Brinkley Company (706.40 shares of appellant taxpayer) [Tr. 121-125]. The Elizabeth C. Tuerk Trust held $20,590 in appellant taxpayers' unsecured notes and Fred R. and George E. O. Tuerk and various trusts for Tuerk relatives (including the Elizabeth C. Tuerk Trust) subscribed for a total of 1,957 shares of Ajax. None of the Tuerks or Tuerk Trusts held any stock of appellant taxpayer. W. A. Hinckley (44 shares of Ajax), Ned Lewis (177 shares of Ajax), and R. B. Mattson and H. A. Magnuson (89 shares each of Ajax) were business associates of Brayton Wilbur (797 shares of appellant taxpayer and 177 shares of Ajax), and it appears that some of the shares of appellant taxpayer's stock registered in the name of Brayton Wilbur were beneficially owned by his business associates above named [Deposition of Wm. A. Hinckley, 12/7/66, pp. 5, 6, 13-16 and Ex. A thereto; Deposition of Herbert Magnuson, 1/11/67, pp. 5, 6] (Exs. R, S, SS).

Exhibit D is a copy of the subscription for Ajax stock and notes executed by Thos. J. Bannan and is typical of the subscriptions executed by the other 21 subscribers

(Admitted Fact XVI, R. 88, 89).

During January, 1957, negotiations and discussions were held between Mr. Bez, who was again assisted by Mr. Beasley, and Seattle-First National Bank, which held the mortgage notes in trust as above stated, and also with various individuals representing, or purporting to represent, various groups of holders of beneficial interests under said trust. These negotiations established that the Trustee Bank was unwilling to take the responsibility of selling the mortgage notes, and that the only feasible manner in which the notes could be acquired would be by purchasing the beneficial interests under said trust directly from the various holders of said beneficial interests. Mr. Beasley was advised by said bank that if all of the beneficial interests could be acquired, the trust could then be dissolved and said mortgage notes transferred to the purchaser of said beneficial interests as an incident of the dissolution of the trust (Admitted Fact XVII, R. 89).

Mr. Bez also approached Seattle-First National Bank with the view of obtaining a bank loan to Ajax to finance the balance of the purchase price. Seattle-First refused to make such a loan. He then approached The Bank of California. The Bank of California agreed to make the loan but conditioned it on a promise by Bez that in the event Ajax purchased the mortgage notes, appellant taxpayer would make a substantial payment to Ajax on the indebtedness in the near future so that the bank loan could be substantially reduced (Tr. 27-29, 92-97; Finding of Fact No. 8, R. 126).

A special meeting of the Board of Directors of The Ajax Company was held on January 30, 1957, at which the president, Mr. Beasley, reported on the situation and recommended that an offer be made by Ajax to purchase the beneficial interests. He reported that he had in his possession subscriptions for an additional 9,693 shares of stock and for stockholder loans in the amount of approximately $129,000 which, together with the subscriptions for 3,235 shares already accepted and called for payment, would provide funds in the amount of $142,000; that arrangements had been made with The Bank of California, N.A. to borrow the balance of the funds necessary to complete the purchase, should the company's offer be accepted; and that this bank loan would be secured by pledging the mortgage notes to the bank (Admitted Fact XVIII, R. 89).

The Board then adopted a resolution providing that an offer be made to the beneficial interest holders at a price of $6.50 per beneficial interest; that The Bank of California, N.A. be appointed escrow agent under the offer, and that the sum of $25,000 earnest money be deposited with said bank; that in the event the offer was accepted, the corporation borrow $650,000 from the bank to provide the necessary additional funds to complete the purchase; that in the event the offer was accepted, all necessary steps be immediately taken to bring about the dissolution of the trust, the distribution of the mortgage notes to the company, and the pledge thereof to the bank; and that a special meeting of the Board be called for February 21, 1957 to take such action as might be appropriate as a result of the response of the beneficial interest holders to the offer. Exhibit B is a copy of the Minutes of said meeting (Admitted Fact XVIII, R. 89).

In accordance with the Board's action, a formal offer, dated February 1, 1957, in the form approved by the Board, was forwarded to each of the 68 beneficiaries under said trust together with a "Letter of Deposit Under Offer of the Ajax Company" and an "Assignment of Beneficial Interest Under Trust" to be executed and forwarded to the escrow bank by beneficial interest holders accepting the offer. Said offer, by its terms, extended until February 21, 1957. A copy of said offer, and of the enclosures above mentioned which accompanied it, are attached to and made a part of the Minutes of said meeting, Exhibit B (Admitted Fact XIX, R. 89, 90).

Also pursuant to the Board's action, arrangements were made with The Bank of California, N.A., to act as escrow agent under said offer, and escrow instructions were prepared and forwarded to said bank, together with the sum of $25,000 as the earnest money specified in said offer. Exhibit E is a copy of said escrow instructions, endorsed as accepted by said bank (Admitted Fact XX, R. 90).

As previously arranged, the Board of Directors of Ajax again met on February 21, 1957, and the President reported that he had been advised by the bank that all of the beneficiaries under the trust had accepted the company's offer and had deposited their Certificates of Deposit in escrow with the bank, together with the necessary Letters of Deposit and assignments, and that the purchase of the beneficial interests as contemplated by the offer had been consummated. The Board then adopted a resolution that the corporation proceed to complete the bank loan from The Bank of California as contemplated and authorized at the last meeting, and do all acts and things necessary or appropriate to complete the purchase and the financing thereof. The additional subscriptions for stock and notes, above mentioned, were then accepted and called for payment. Exhibit C is a copy of the Minutes of said meeting (Admitted Fact XXI, R. 90).

Immediately following this meeting, all necessary steps were taken by the President and Secretary of Ajax to consummate the purchase of said beneficial interests in accordance with the offer and the resolutions of the Board of Directors above mentioned. Exhibit F is a copy of the communication from The Ajax Company to the escrow bank, authorizing consummation of the purchase (Admitted Fact XXII, R. 90, 91).

Upon the consummation of the purchase of the beneficial interests as above stated, the Certificates of Beneficial Interest, accompanied by Assignments from the former holders thereof to The Ajax Company, were immediately transmitted to Seattle-First National Bank, as Trustee under said trust, together with a written request that the assets of said trust be distributed to The Ajax Company as sole beneficiary thereunder. Exhibit H is a copy of said written request (Admitted Fact XXIII, R. 91).

In response to said request, Seattle-First National Bank delivered the mortgage notes and the collateral held as security therefor to The Ajax Company, together with an instrument of transfer entitled "Transfer of Assets Upon Distribution of Trust." Exhibit I is a copy of said instrument of transfer (Admitted Fact XXIV, R. 91, 92).

Upon receipt of the mortgage notes and collateral, The Ajax Company immediately assigned and delivered them to The Bank of California, N.A. as security for the indebtedness of The Ajax Company to The Bank of California, N.A. in the amount of $642,000. Exhibit J is a copy of said assignment, and Exhibit K is a copy of the receipt issued by said bank to The Ajax Company for said collateral (Admitted Fact XXV, R. 92).

The aggregate net purchase price for the 119,112 beneficial interests purchased by Ajax as hereinabove stated was the sum of $774,228 (Admitted Fact XXVII, R. 92).

The Ajax Company received the following amounts from the subscribers for its stock and notes:

For 12,928 shares of stock at $1.00 per share,	$ 12,928.00
For 5-year 6% notes at face value	129,300.52
TOTAL	$142,228.52

The balance of the funds necessary to complete the purchase were from the proceeds of the bank loan made by Ajax from The Bank of California in the amount of $642,000 (Admitted Facts XXVIII, XXIX, R. 93; Finding of Fact No. 7, R. 126).

As of February 21, 1957, the date of the purchase, no payments on the principal of the indebtedness evidenced by the mortgage notes had been made, but all accrued interest thereon had been paid except interest for the two years ended 3/31/54 and 3/31/55,[6] and interest for the current year ending 3/31/57 which was not yet payable (Admitted Fact XXVII, R. 92).

On April 2, 1957, interest on the mortgage notes for the year ended March 31, 1957 in the amount of $66,-

(6) Interest for these years had been deferred until May 31, 1960 by previous agreement between Appellant Taxpayer and Seattle-First National Bank (Admitted Fact XXVII, R. 92).

737.28 was paid by appellant taxpayer to Ajax. On May 17, 1957, $60,000 of said funds was paid by Ajax to the bank and applied in payment of interest and reduction of principal of that company's indebtedness to the bank. Pursuant to action by the Board of Directors of appellant taxpayer taken at its annual meeting, May 17, 1957, and approved by its stockholders at their annual meeting held on the same day, on May 23, 1957, appellant taxpayer made a principal payment in the amount of $400,-000 to Ajax on the indebtedness evidenced by said mortgage notes. None of the principal of said notes was then due and payable, and said $400,000 payment constituted a pre-payment of principal. Exhibits AA and BB are copies of the Minutes of said stockholders and directors meetings of appellant taxpayer. Out of the funds so received, Ajax paid the bank the sum of $399,677 in payment of accrued interest to date on its bank loan, and the balance in reduction of principal (Admitted Facts XXIX, XXX, XXXVI, R. 93, 94, 97; Exs. O, Q; Tr. 34, 35, 128).

On October 2, 1957, Ajax paid the accrued interest on its said bank loan to date and executed a renewal note to the bank for the principal balance in the amount of $192,000. Thereafter, Ajax paid the accrued interest on said renewal note monthly to the bank (Admitted Fact XXIX, R. 94, Ex. Q).

On April 4, 1958, accrued interest on the mortgage notes for the year ended March 31, 1958 was paid by appellant taxpayer to Ajax. However, no further principal payments were made by Ajax on its bank loan until March 6, 1959, when a payment of $40,000 was made, reducing the bank indebtedness to $152,000. Thereafter, additional principal payments on its bank loan by Ajax were made as follows: On June 20, 1960, $52,000; on March 2, 1961, $50,000; and the final principal balance of $50,000 on March 1, 1962 (Admitted Fact XXX, R. 94, Ex. Q).

Appellant taxpayer's Alaska salmon fishing operations during the 1958 season were relatively successful and resulted in a substantial profit. However, the immediate prospect of the elimination of salmon traps in Alaska and other problems created by Alaska statehood caused certain of the directors and stockholders of appellant taxpayer to be pessimistic with respect to the prospects for the 1959 season. A meeting of the Board of Directors of appellant taxpayer was held December 10, 1958, at Seattle, Washington, to consider the situation. It was the sense of the meeting that due to these problems, a further study of the situation was required to better determine the future course of the business and operations of the company. Consequently, said meeting was adjourned to January 14, 1959, when it was reconvened at the California Club, Los Angeles, California. At the reconvened meeting, the question of determining the future course of the company and its business in view of the Alaska situation was considered at length. In this connection, the following possibilities were considered: First, dissolution and liquidation of the company; second, consolidation of the operations of the company with those of Peninsula Packers[7]; third, the purchase by Mr. Bez and Mr. Tuerk of the stock and notes held by the other stockholders and noteholders of the company. Substantial objections were raised as to each of these possibilities. Two of the di-

(7) See footnote (5). Peninsula Packers was also engaged in the salmon canning business in Alaska.

rectors then joined in a suggestion that Mr. Bez be given an option on all of the stock and notes of appellant taxpayer and Ajax held by the other persons present at the meeting, the price to be the par value of the stock and the face value of the notes. It was a part of this proposal that the option run to March 31, 1959, but that it be given on condition that no decision would be made during the period of the options to operate or not to operate appellant taxpayer's plants for the coming season, and that Mr. Bez would not permit any substantial funds of the company to be committed for the operation of the company's plants during that time unless he was instructed to do so by the Board. Exhibits CC and DD are copies of the minutes of said meetings (Tr. 38-50, 113, 114, 128-134; Deposition of Jacques Bergues, 12/6/66, pp. 15-17; Admitted Facts XXXVI, XXXVII).

All parties present at the meeting indicated that they would be willing to give such an option to Mr. Bez and that they would use their best efforts to persuade the other security holders whom they respectively represented to join in such an option (Ex. DD).

Accordingly, options in the form set out in Exhibit FF were prepared and forwarded to each of said directors[8] with a letter confirming Mr. Bez' assurance that no decision would be made to operate appellant taxpayer's plants or to commit substantial funds for such operations unless he was instructed by appellant taxpayer's Board to do so (Admitted Fact XXXVII, R. 97, Ex. EE).

By March 6, 1959, Mr. Bez had received options cov-

(8) Donald Royce, Fred R. Tuerk, Thos. J. Bannan and Jacques Bergues; and also to George Darneille, a stockholder, who had been present at the meeting (Exs. DD, EE).

ering all outstanding stock and unsecured notes of appellant taxpayer and of Ajax, except as indicated below:

Appellant Taxpayer

	Stock	*Notes*
Covered by Options	10,941.9 shares	$510,581.00
Owned by Peninsula Packers	2,735.0 shares	127,650.00
Owned by Trans-Pacific Fishing & Packing Co.	352.0 shares	16,480.00
Owned by Nick Bez	442.1 shares	20,579.00
Total	14,471.0 shares	$675,290.00

The Ajax Company

	Stock	Notes
Covered by Options	9,898.5 shares	$ 94,007.37
Owned by Peninsula Packers	2,735.0 shares	27,350.00
Owned by Trans-Pacific Fishing & Packing Co.	352.0 shares	3,520.00
Owned by Nick Bez	442.5 shares	4,423.15
Total	12,928.0 shares	$129,300.52

(Admitted Fact XXXVIII, R. 97).

Said options were taken by Mr. Bez for the benefit of the partnership Peninsula Packers,[9] and, on March 4, 1959, an Amendment to Partnership Agreement was executed by the partners providing for the assignment to Ajax of the options to purchase the appellant taxpayer stock and Ajax notes; the assignment to appellant taxpayer of the options to purchase the appellant taxpayer notes; the contribution to the partnership of the securites of appellant taxpayer and Ajax owned by Nick Bez and Trans-Pacific Fishing & Packing Co.; and the contribution to Ajax of all appellant taxpayer stock owned by the partner-

(9) See footnotes (5) and (7).

ship (Admitted Facts XXXVIII, XXXIX, R. 97-99; Ex. HH).

The options were assigned and exercised accordingly and Seattle-First National Bank was appointed to receive the securities on behalf of the purchasers and to disburse the option price to the sellers. This was accomplished in accordance with the terms of a letter of instructions from Nick Bez, Peninsula Packers, The Ajax Company, and appellant taxpayer to the bank (Admitted Fact XXXVIII, R. 98, 99; Ex. GG).

As a result of the purchase of the securities covered by the options as above stated, and the contribution of the appellant taxpayer stock already owned by Peninsula Packers to The Ajax Company, as above stated—

1. Peninsula Packers became the sole stockholder of The Ajax Company; and

2. The Ajax Company became the sole stockholder of appellant taxpayer (Admitted Facts XXXIX-XLII, R. 99, 100; Exs. HH, II, JJ).

The Ajax Company has remained the sole stockholder of appellant taxpayer at all times since (Admitted Fact XLI, R. 99).

The Peninsula Packers Amendment to Partnership Agreement above referred to (Ex. HH) also provided that Trans-Pacific Fishing & Packing Co. would contribute ten gill net boats which it owned in Alaska to the partnership, and that the partnership would, in turn, contribute all floating equipment which it owned, including the ten gill net boats above mentioned, its Naknek campsite inventory and supplies, and all other miscellaneous operating equipment, supplies and furniture to The Ajax Company. Peninsula also agreed to contribute 1,000 shares (all) of the stock of Global Fishing Company to Ajax.

These contributions were accepted by resolution of the Board of Directors of Ajax at a meeting held March 25, 1959 and all tangible operating equipment and supplies so received by Ajax were, in turn, contributed to the capital of appellant taxpayer except the vessels *Nomad* and *Deer Harbor*, which were retained by and are still owned by Ajax. Exhibit JJ is a copy of the minutes of this meeting. The *Nomad* has not been operated, but the *Deer Harbor* has been operated by The Ajax Company as a cannery tender in Alaska and for transporting fishing equipment and supplies between Puget Sound and Alaska during each of the fishing seasons 1959-1965 (Admitted Fact XLII, R. 99, 100).

After acquiring all of the stock of Global Fishing Company on March 25, 1959, The Ajax Company caused Global Fishing Company to be merged into appellant taxpayer, and said merger became effective July 1, 1959. Global Fishing Company had been actively engaged in the fishing industry since its organization in 1950, and in Alaska since the 1954 fishing season (Admitted Fact XLII, R. 100).

The operations of appellant taxpayer's business require large borrowings from banks, particularly prior to and during the Alaska salmon fishing season, to finance its salmon pack. Large bank credits are also required in connection with the purchase of salmon packed by others. In this connection, appellant taxpayer has been dependent upon the lines of credit extended to it by its banks. Upon the acquisition of all of the outstanding stock of appellant taxpayer by The Ajax Company, the banks indicated that it would be desirable to eliminate the mortgage indebtedness owing by appellant taxpayer under the mortgage notes. However, as above stated, said mortgage notes were held by The Bank of California as collateral for the balance owing by Ajax on its loan from the bank. Consequently, on June 29, 1959, Ajax entered into a letter agreement (Ex. LL) with the bank, whereby Ajax agreed to pledge all of the issued and outstanding stock of appellant taxpayer to the bank to secure said loan, and the bank agreed to accept said stock as substitute collateral and release the mortgage notes from its pledge. Ajax further agreed that upon the release to it of the mortgage notes, it would contribute them to the capital of appellant taxpayer so that said mortgage indebtedness would be converted into equity capital of appellant taxpayer. Said substitution of collateral was effected and, upon the release of said mortgage notes by the bank to Ajax, Ajax contributed the same to the capital of appellant taxpayer. Entries were made in appellant taxpayer's books of account to reflect an increase in its paid-in capital in the amount of the unpaid balances under said mortgage notes and a corresponding reduction in its long-term debt (Admitted Facts XXXIV, XLIV, R. 94, 100, 101; Exs. KK, LL, MM).

Since its organization on May 21, 1956, The Ajax Company has maintained separate books of account, has filed Federal income tax returns for each of its fiscal years, commencing with the year ended March 31, 1957, and has held regular stockholders' and directors' meetings (Admitted Fact XLV, R. 101).

SPECIFICATION OF ERRORS

The specification of errors relied upon and which are intended to be urged are as follows:

1. The trial court erred in concluding that the substantive corporate existence of Ajax should not be recognized for Federal tax purposes because tax avoidance was the primary, dominant and moving purpose for its formation and for its single business activity (Memo. Dec., R. 115-118). Said conclusion is erroneous in that negotiations for and the purchase of mortgage notes at a discount from unrelated third parties is a business activity with a clear commercial purpose; and the fact that appellant taxpayer could have purchased them does not rob the purchase by Ajax of its character as a business activity to be recognized as such for Federal tax purposes, whatever tax avoidance motives may have been involved.

2. The trial court erred in concluding that appellant taxpayer's mortgage notes were in substance purchased by appellant taxpayer and should be so treated for purposes of determining the Federal income tax liability; and that, accordingly, appellant taxpayer realized taxable income under Section 61(a)(12) of the Internal Revenue Code of 1954 upon the purchase of said notes at a discount (Conclusion of Law No. 1, R. 127). Said conclusion is erroneous in that the Admitted and Stipulated Facts (R. 84-104) and undisputed evidence establish that said mortgage notes were purchased by The Ajax Company and not by appellant taxpayer; and no legal basis exists for attributing the purchase of said notes to appellant taxpayer for purposes of determining its Federal income tax liability.

3. The trial court erred in concluding that the net operating loss deductions claimed by appellant taxpayer are disallowed by Section 269(a) of the Internal Revenue Code of 1954 (Conclusion of Law No. 2, R.127). Said conclusion is erroneous in that (i) neither appellant taxpayer nor Ajax acquired control over the other, and the acquisition of such control is essential to the application of Section 269(a); and (ii) appellant taxpayer did not secure the benefit of a deduction, credit or other allowance which it would not otherwise have enjoyed.

4. The trial court erred in finding that 85.44 per cent of appellant taxpayer's stockholders committed themselves to purchase Ajax stock and five-year notes (Finding of Fact No. 5, R. 125). Said finding of fact is erroneous in that it is contrary to the stipulated facts contained in the exhibits jointly offered by both parties (Exs. R, S, SS).

5. The trial court erred in finding that appellant taxpayer paid Ajax $66,737.38 on May 17, 1957 (Finding of Fact No. 8, R. 126). Said finding of fact is erroneous in that it is stipulated by the parties that said payment was in fact made on April 2, 1957 (Admitted Fact No. XXX, R. 94).

6. The trial court erred in entering the Judgment of Dismissal (R. 128) and in failing to enter judgment for appellant taxpayer on the issues presented.

SUMMARY OF ARGUMENT

The argument falls into two basic parts, first, a discussion of the legal consequences of a purchase of an indebtedness at a discount by a corporation organized for that purpose by a majority of the stockholders of the debtor corporation where the primary purpose of doing so was tax avoidance and, second, a discussion of the application of Section 269(a)(1) to the transactions involved in this proceeding.

The argument may be summarized as follows:

Part I: The admitted facts establish (a) that appellant taxpayer did not, in fact, purchase the mortgage notes, and (b) that Ajax was organized by stockholders of appellant Taxpayer for the purpose of purchasing the mortgage notes and did, in fact, purchase them.

It has been firmly established by the authorities that the motive of tax avoidance will not establish tax liability if the transaction does not do so without it, and the purchase of an indebtedness at a discount by stockholders of the debtor corporation, or by a new corporation organized by them for that purpose, does not constitute an acquisition of the indebtedness by the debtor corporation. Thus, the trial court's determination that the purchase of the mortgage notes by Ajax must be attributed to appellant taxpayer solely on the basis that the primary purpose of the organization of Ajax and its purchase of the mortgage notes was tax avoidance, is error.

Part II: Section 269(a)(1) cannot apply to the situation here involved because appellant taxpayer did not acquire control of Ajax, nor did Ajax acquire control of appellant taxpayer. The acquisition of such control is essential to the application of this section, and the fact that two corporations have the same, or largely the same, stockholders does not constitute control by one of them over the other within the meaning of this section.

Section 269(a)(1) cannot apply for the additional and independent reason that appellant taxpayer did not secure the benefit of a deduction, credit or other allowance which it would not have otherwise enjoyed. The operating loss deductions in question will be enjoyed in full, either by application in the year ended March 31, 1957, as the Government contends, or by application in the years ended March 31, 1960, and March 31, 1961, as appellant taxpayer contends. The Government does not seek to disallow any portion of the deductions, but merely to charge appellant taxpayer with additional tax in the earlier year, whereby the benefit of the operating loss deductions would be enjoyed in that year rather than in later years.

ARGUMENT

Part I

The Section 61 Issue[10]

The Mortgage Notes Were Acquired by Ajax On Behalf of Its Stockholders, Not by Appellant Taxpayer.

There is no dispute as to the material facts in this proceeding. They are largely stipulated as Admitted Facts in the Pre-Trial Order and by the exhibits referred to in the Admitted Facts or otherwise jointly offered by the parties (R. 112).

(10) Section 61(a)(12) of the Internal Revenue Code of 1954, insofar as claimed by the Government to be applicable, provides as follows:

"Sec. 61. GROSS INCOME DEFINED

"(a) GENERAL DEFINITION.—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

* * *

"(12) Income from discharge of indebtedness;

* * *"

For the full text of Section 61(a), see Appendix A, page A-I, *infra.*

The issue in this phase of the case is the correct legal consequences to be derived from these facts.

It has been stipulated that when the possibility of acquiring the mortgage notes at a discount arose, Mr. Bez, its president, became interested in the acquisition of the notes by appellant taxpayer to the extent that he inquired of its legal and accounting advisors as to the Federal income tax consequences in the event appellant taxpayer were to acquire the notes. He was advised that any acquisition of the notes by appellant taxpayer at a substantial discount would result in the realization of taxable income in an amount equal to the discount. It is stipulated that on the basis of this advice, he concluded that it would not be feasible for appellant taxpayer to attempt to acquire the notes. It is further stipulated that his reason for arriving at this conclusion was that the immediate income tax liability which would be incurred as a result of the acquisition would increase the overall cost of the notes to an amount which appellant taxpayer could not afford to pay (Admitted Fact XIV, R. 87, 88). The evidence shows that but for the impact of the tax, it would have been desirable for appellant taxpayer to attempt to purchase the notes. Thus, under the stipulated facts and undisputed evidence, the primary, if not the sole, reason that appellant taxpayer abandoned the idea of purchasing the notes was that to do so would incur an unacceptable tax liability. This has been stipulated and openly conceded by appellant taxpayer throughout this entire proceeding, and this tax avoidance motive on the part of appellant taxpayer is not denied.

It also cannot be denied, however, that appellant taxpayer had a perfect right to elect not to purchase the notes, and that the tax consequences of doing so was a perfectly legitimate reason for its decision. Under the circumstances, it would have been most improvident for appellant taxpayer to have made the purchase.

It is further stipulated that having determined that a purchase of the notes by appellant taxpayer was not feasible, Bez, who was a substantial stockholder, began to explore the possibility of joining with other stockholders for the purpose of attempting to purchase the notes; that he caused the Ajax Company to be organized for that purpose; that he solicited the other stockholders for subscriptions for stock and notes of Ajax; that a large majority agreed to subscribe providing $142,228.52 toward the funds necessary to make the purchase; that arrangements were made on behalf of Ajax to borrow the balance of the necessary funds from The Bank of California; that Ajax made a formal offer to 68 holders of the beneficial interests under the trust which held the mortgage notes; that Ajax' offer was accepted by all of them; that Ajax borrowed $642,000 form the bank to make up the balance of the purchase price; that the purchase was completed and the mortgage notes, together with the mortgages which secured them, were assigned to Ajax; and that Ajax immediately pledged and delivered the mortgage notes to the bank as collateral for its bank loan (Admitted Facts XV-XXX, R. 88-94).

Again, it cannot be denied that the stockholders had a perfect right to purchase these notes if they chose to do so, and a perfect right to organize and employ a separate corporation as a vehicle to accomplish that purpose. The fact that it would have been desirable for appellant taxpayer to purchase the notes, that appellant taxpayer may have been able to purchase them if it could have afforded to do so, and the fact that the stockholders undoubtedly had a special interest in purchasing these notes because of their interest in appellant taxpayer, can in no way bar or limit the right of the stockholders to purchase the notes if they wished to do so.

The Government contends that the corporate entity of Ajax should be disregarded because its purchase of the mortgage notes was a sham transaction entered into solely to escape taxation and having no commercial or industrial purpose (R. 115). The trial court, however, carefully refrained from characterizing either Ajax, as such, or the purchase of the mortgage notes as sham. On the contrary, the court below recognized the purchase of the mortgage notes by Ajax as "its single business activity" (R. 116, 117; Finding of Fact No. 9, R. 126). It held, however, that without the purpose of tax avoidance, Ajax would never have been organized and, that since tax avoidance was the primary, dominant, moving purpose for the formation of Ajax and for its single business activity in purchasing the mortgage notes, the substantive corporate existence of Ajax should not be recognized for Federal tax purposes (R. 117).

How such a determination would result in the attribution of the purchase to appellant taxpayer rather than to the stockholders of Ajax is not explained.[11]

As above stated, however, it has been expressly stipulated by the parties:

1. That appellant taxpayer did not, in fact, purchase the mortgage notes; and

(11) See page 54, *infra*.

2. That stockholders of appellant taxpayer organized Ajax to buy the notes and contributed their own personal funds in a substantial amount for that purpose, and that Ajax did, in fact, buy the notes and hold and deal with them as the owner.

The sole basis relied on by the trial court for attributing the purchase to appellant taxpayer was its determination above stated, that tax avoidance was the primary, dominant, moving purpose for the formation of Ajax and its purchase of the mortgage notes (R. 117).

That this was error is fully demonstrated by the authorities.

The Motive of Tax Avoidance Will Not Establish Liability if the Transaction Does Not Do So Without It.

The basic principle established by the Supreme Court in the case of *Gregory v. Helvering*, (1935) 293 U.S. 465, 55 S.Ct. 266, 79 L.Ed. 596, stated in the subheading above has been the subject of countless decisions of the Federal courts and of the Tax Court. One of the best known and most cited of these cases is the decision of the Second Circuit Court of Appeals by Judge L. Hand in *Chisholm v. Comm'r* (2d Cir. 1935), 79 F.2d 14. This case explains the essence of this principle with great clarity and highlights the true significance of a tax avoidance purpose on the part of a taxpayer.

In that case, Chisholm and his brother each owned 300 shares of stock in an engineering corporation. Together with the other stockholders of the corporation, they granted a thirty-day option for the sale of this stock. If consummated, the sale would result in a large capital gain. The brothers' attorney told them that by forming a partnership they might postpone and perhaps altogether escape the taxes which would otherwise become due upon the sale. For this reason they formed a partnership and transferred to it the shares of stock in question and its only asset. Two days later, the option was exercised and the stock sold by the partnership. The partnership was not dissolved and was still in existence at the time of the trial. The brothers continued to hold its assets in common as partners, bought and sold securities with the capital, and had not distributed any principal. The commissioner assessed deficiencies against each partner on the theory that he had realized a gain on the sale of the stock, and the Board of Tax Appeals affirmed this ruling. The Board's decision is reversed by the Court of Appeals.

The basis of the Board's decision was that the partnership was formed confessedly to escape taxation. In this connection, the court said (at page 15):

> "The Board thought that for this reason the transaction was not 'bona fide,' and that the business of the firm was not business properly speaking at all. The commissioner believes that the situation falls within *Gregory v. Helvering*, 293 U.S. 465, 55 S.Ct. 266, 79 L.Ed. 596. It is important to observe just what the Supreme Court held in that case. It was solicitous to reaffirm the doctrine that a man's motive to avoid taxation will not establish his liability if the transaction does not do so without it. It is true that that court has at times shown itself indisposed to assist such efforts, * * * (citing cases) * * * ; but it has never, so far as we can find, made that purpose the basis of liability; and it has often said that it could not be such. The question always is whether the transaction under scrutiny is in fact what it appears to be in form; a marriage may be a joke; a contract may be intended only to deceive others; an agreement may have a collateral defeasance. In such cases the transaction as a whole is different from its appearance. * * * We may assume that purpose may be the touchstone, but the pur-

> pose which counts is one which defeats or contradicts the apparent transaction, not the purpose to escape taxation which the apparent, but not the whole, transaction would realize. In *Gregory v. Helvering, supra,* * * *, the incorporators adopted the usual form for creating business corporations; but their intent, or purpose, was merely to draught the papers, in fact not to create corporations as the court understood that word. That was the purpose which defeated their exemption, not the accompanying purpose to escape taxation; that purpose was legally neutral. Had they really meant to conduct a business by means of the two reorganized companies, they would have escaped whatever other aim they might have had, whether to avoid taxes, or to regenerate the world."

On the basis of the above stated principles, the court held that since an enduring partnership had, in fact, been formed and had continued to hold the joint principal and to invest and reinvest it, the fact that the dominant or sole purpose for its formation was to escape taxation would not alter its tax status.

The basis of the trial court's holding in the case at bar is precisely the same as that of the Board of Tax Appeals in *Chisholm.* Based solely on his finding that the purpose for forming Ajax and the purchase of the mortgage notes by Ajax was tax avoidance (Finding of Fact No. 10, R. 127), he has concluded that such purchase of the notes was not business, properly speaking, at all (Memo. Dec., R. 116, 117). Thus, the trial court has fallen into the same error as the Board in *Chisholm,* that the motive to avoid taxation does indeed establish a taxpayer's liability where the transaction would not do so without it. The purchase of mortgage notes at a discount from unrelated taxpayers could not, under any circumstances, result in tax liability unless the notes are actually or constructively acquired by the debtor. Thus, if the purchase by Ajax, which was not the debtor, would not constitute an acquisition by the debtor without the tax avoidance motive, the existence of the tax avoidance motive would not change the situation. The question as to whether or not the relationship of appellant taxpayer and its stockholders would, absent a tax avoidance motive, result in the attribution of the acquisition to appellant taxpayer, will be discussed at a later point in this brief.

As in *Chisholm,* Ajax has not dissolved and is still in existence (Admitted Facts XLI, XLII, R. 99, 100). During the period from the date of the acquisition of the mortgage notes until March 25, 1959, the business activity of Ajax was confined to holding the mortgage notes and related activities such as receiving the payments made thereon, servicing its bank loan, paying interest to its own note holders, filing income tax returns, and holding corporate meetings (Admitted Facts XXIX, XXX, XL, XLV, R. 93, 94, 99, 101; Tr. 56). On March 25, 1959, Ajax became the sole stockholder of appellant taxpayer and remains so to the present time. In addition, Ajax has engaged in substantial fishing operations in Alaska during each fishing season commencing with the 1959 season (Admitted Facts XLI, XLII, R. 99, 100).

Under the stipulated facts there can be no doubt that the stockholders in the case at bar really meant to conduct the business of negotiating for and purchasing the mortgage notes by means of Ajax and, as so aptly stated in the above quotation, have thus "escaped whatever other aim they might have had, whether to avoid taxes, or to regenerate the world."

Another decision, by the Fifth Circuit, which points up the common error which so often occurs in applying the rule of *Gregory* is *Sun Properties v. U.S.*, (5th Cir. 1955) 220 F.2d 171. In that case, the question was whether the conveyance of a warehouse property to the taxpayer corporation by its sole stockholder, in the form of a sale, was in substance a contribution to capital. Shortly after the corporation was organized, the stockholder sold the warehouse to it for $125,000 payable in semi-annual installments of $4,000 without interest. The trial court held that the transaction was made to reduce taxes and achieved no legitimate business purpose, and that the stockholder would not have entered into the transaction except for tax purposes. On this basis, it held that the transaction constituted a contribution to capital rather than a sale.

With respect to the trial court's determination that the decisive consideration motivating the transaction was the minimizing of taxes and that such was the only business purpose of the transaction, the Circuit Court said at page 174:

> "What about the fact, which we may assume to be true, that Peacock's predominant motive was to minimize taxes? In *Gregory v. Helvering*, 293 U.S. 465, 469, 55 S.Ct. 266, 79 L.Ed. 596, 97 A.L.R. 1355, the Supreme Court said that a motive of tax avoidance will not establish liability if the transaction does not do so without it. It may fairly be said that a tax avoidance motive must not be considered as evidence that a transaction is something different from what it purports to be. 8th Ann. N.Y.U. Institute on Federal Taxation 990, 1003:
>
> "'Transactions are properly subject to careful scrutiny when the only ascertainable motive is tax avoidance, just as they are subject to scrutiny

> when between the members of a family. The error into which the courts have fallen, however, is that they have elevated the rule of careful scrutiny into a rule which changes the substantive effect of the evidence found. Although transactions like these should be carefully studied they should be treated for tax purposes, on the basis of this careful study, just like tax cases where tax avoidance is not a motive.' "

As stated by the court with respect to the error above referred to:

> "This rationale is perilously plausible. It is in effect saying to the taxpayer, 'You did this under suspicious circumstances; therefore, you did not do it at all and you are not entitled to any tax advantages.' " 220 F.2d at 173

On this basis, the Circuit Court held that since the transaction in question was carried out as a sale in all respects, the fact that the sole motive was tax avoidance would not justify treating it as something else, since (page 174):

> " '* * * Legal transactions cannot be upset merely because parties have entered into them for purpose of minimizing or avoiding taxes which might otherwise accrue'."

The error pointed out above in the quotation from the N.Y.U. Institute on Federal Taxation in *Sun Properties* is especially well illustrated by the action of the Tax Court, which is reversed in *Friedlander Corp. v. Comm'r*, (5th Cir. 1954) 216 F.2d 757. In that case, a family partnership composed of substantially all of the stockholders of the taxpayer corporation was formed to take over the larger portion of the department store and hardware business of the corporation. The primary motive for forming the partnership was to reduce tax liability. In reversing the decision of the Tax Court, the Circuit Court said at page 759:

> "For here, the majority, rejecting the stipulated and undisputed facts that the partnership was formally created and activated, and for years carried on a large business, and seizing, as determinative of the question at issue, upon the admitted fact that the partnership was formed because of the advice of a tax accountant and consultant that there would be less liability if the stores were owned by a partnership, and stating: 'The primary motive for forming the partnership was to reduce tax liability,' concluded in the teeth of the overwhelming, indeed undisputed, oral and physical evidence to the contrary, that 'The parties did not in good faith and acting with a business purpose intend to join together as partners in the present conduct of an enterprise.' So concluding, and without a syllable of evidence or a real fact to the contrary, it erroneously declared and held that the large income in fact earned by the partnership and its members throughout the years was not earned by it but by the petitioner and was, therefore, taxable not to the partnership but to it."

In commenting upon the manner in which the Tax Court had dealt with the case, the court said at page 759:

> "Saying, and thus giving lip service to the settled rule of law, 'that a taxpayer may select any form or organization through which to conduct business and is under no compulsion to adopt a type that will yield the greatest amount of tax revenue,' and again, 'Louis, the architect of the plan, testified, in effect, that taxation was the predominant motive for creation of the partnership. Such a purpose, if the plan for its accomplishment is not unreal or a sham, is of course not fatal. * * *,' the majority proceeded by the same kind of unpermissible fiating which has been condemned in the cases, to attribute to petitioner income earned not by it but by the partnership."

The court also pointed out that the Tax Court's determination in the particular case ran counter to settled law established by numerous Federal cases and by the Tax Court itself in prior cases.

As stated by this court in *Twin Oaks Co. v. Comm'r,* (9th Cir. 1950) 183 F.2d 385, the error in dealing with the tax avoidance motive which is pointed up in the cases just discussed often results in the denial to a taxpayer of the legal right to conduct his business affairs through the medium of his own choice. Where the acts of a partnership are held to be in substance the acts of a corporation, or the acts of one corporation are held to be in substance the acts of another corporation, solely on the basis of the existence of a tax avoidance motive, the legal right of the taxpayer to conduct his business affairs through the medium of his own choice is effectively denied. In *Twin Oaks*, two individuals and the wife of one of them owned all of the stock of the taxpayer corporation which was engaged in the business of dealing in builder's materials. The stockholders entered into a partnership and took over the business of the corporation, purchasing its operating assets and leasing its real estate on which the business was conducted. The commissioner assessed tax deficiences against the corporation on the theory that the partnership had been created solely as a device to avoid taxes and, hence, the profits of the partnership should be taxed to the corporation. The Tax Court sustained the assessment on the ground that the transfer of the operating assets of the corporation to the partnership had been "forms without substance" and were not entitled to recognition for tax purposes.

The decision of the Tax Court is reversed. The Circuit Court states that there could be no doubt that it was the intent of the parties to thereafter conduct the business as a partnership, that the partnership was actually formed, that the corporate stockholders as members of the partnership were subject to unlimited personal liability in place of the limited liability to which they had previously been subject, and that the profits of the business were thereafter distributed among the partners in accordance with the agreed partnership interests and not in accordance with their stock holdings in the corporation.

With respect to the situation thus presented, this court said at page 387:

> "It is, as the Tax Court observed, well settled that a taxpayer is free to adopt such legal organization for the conduct of his affairs as he may choose; he may convert from the corporate method to the partnership method of doing business and, though his motive in so doing be to reduce taxes, the conversion must be accorded recognition unless it is such a sham, such a change in form only, without substance, as to require that it be disregarded for tax purposes. *Helvering v. Clifford*, 309 U.S. 331, 60 S.Ct. 554, 84 L.Ed. 788. It seems clear to us, however, that the Tax Court, in its characterization of the change in business structure involved in the instant case as a sham and a mere form without substance, has, in effect denied the taxpayers the legal right to conduct their business affairs through a medium of their own choice."

As in *Twin Oaks*, in the case at bar there can be no doubt that Ajax was actually formed by stockholders of appellant taxpayer for the purpose of acquiring the mortgage notes, that such stockholders contributed substantial amounts of their own personal funds to Ajax, that some of appellant taxpayer's stockholders did not participate, that others participated to a greater or lesser extent than their participation in appellant taxpayer, that Ajax actually purchased the notes and borrowed substantial funds from a bank to do so, and dealt with the notes as the owner thereof. It was clearly the legal right of these stockholders and of Ajax to do this, and the decision of the trial court effectively denies them this right.

To the same effect in the Tax Court see also: *Acampo Winery & Distilleries, Inc.*, (1946) 7 T.C. 629, 635, 636.

Negotiations for and Purchase of Mortgage Notes at a Discount From Unrelated Third Parties Is a Legitimate Business Activity With a Clear Commercial Purpose.

In order to be a separate jural person for purposes of taxation, a corporation must engage in some industrial, commercial or other activity besides avoiding taxation. In other words, the term "corporation" is interpreted to mean a corporation which does some "business" in the ordinary meaning, and escaping taxation is not "business" in the ordinary meaning. *Nat'l Investors Corp. v. Hoey*, (2d Cir. 1944) 144 F.2d 466. As the cases previously discussed clearly show, however, this does not mean that an activity which is clearly a business activity is robbed of its character as such simply because the taxpayer's motive was to avoid taxation. The point made by *Hoey* is that a corporation does not qualify as a separate jural person merely by existing and doing nothing. Judge Hand points out that this doctrine has sometimes been understood to contradict the doctrine that the motive to avoid taxation is never, as such, relevant, but states at page 468:

"In fact it does not trench upon that doctrine; *"

As a matter-of-fact, *Hoey* affirmatively recognizes that minimal activity on the part of a corporation is all that is required. Thus, in *Hoey,* a subsidiary organized by the taxpayer to take and hold common stock and warrants of three of the other subsidiaries of the taxpayer pending consummation of a reorganization plan, was held to be engaged in business. When the reorganization plan failed and there was no longer any reason for continuing the subsidiary in existence, it was held that the subsidiary was no longer engaged in business, notwithstanding the fact that it still retained the securities which had been transferred to it.

The negotiation for and purchase of the mortgage notes at a discount from third parties under circumstances such as those presented in the case at bar certainly constitute a business activity with a clear commercial purpose. This does not appear to be denied. The point made by the trial court is that the purchase by Ajax was motivated solely by tax avoidance because the notes could have or should have been purchased by appellant taxpayer, and that it is this circumstance that robs the purchase by Ajax of its character as a business activity. Such a conclusion, in the words of *Hoey,* clearly would trench upon the doctrine that the motive to avoid taxation is never, as such, relevant (144 F.2d at p. 468).

If such were the rule, any act or activity engaged in through the instrumentality of a corporation for the purpose of minimizing taxes would be robbed of its otherwise true character as a business activity. The common business practices which would thus be challenged would be beyond number.

The authorities discussed in the preceding subsection of this brief, as well as *Hoey*, make it clear that this cannot be the rule.

The Purchase of an Indebtedness by the Stockholders of the Debtor Corporation, or by a New Corporation Organized by the Stockholders for That Purpose, Does Not Constitute an Acquisition of the Indebtedness by the Debtor Corporation.

In the case at bar, appellant taxpayer and the Ajax Company are what is sometimes referred to as brother and sister corporations; that is, two corporations with a substantial identity of stockholders. This is a common relationship in many areas of corporate activity where for one reason or another various business activities or various segments of a single business activity have a common ownership but are conducted by separate corporate entities. In this form of corporate structure, the related corporations do not hold stock interests in each other as in the case of parent and subsidiary corporations. On the contrary, their relationship is based solely on the circumstance that the stock of each of them is held by the same or largely the same stockholders. Thus, in the present case, appellant taxpayer owned no stock interest in Ajax, and Ajax owned no stock interest in appellant taxpayer, at least until March 25, 1959. As observed by the trial court in its memorandum decision, there was a close stockholder relationship between the two corporations (R. 116). However, as outlined in the Statement of Facts above, there was at the same time a substantial divergence in the stockholdings of the two corporations (Exs. R, S, SS).

However, it is firmly established by the authorities that where one party acquires the debt of another the relationship of the parties one to the other does not change the character of the transaction. Thus the acquisition of an indebtedness by the stockholders of the debtor corporation does not constitute an acquisition of the indebtedness by the debtor corporation *Koppers Co.*, (1943), 2 T.C. 152. The fact that the stockholders organize and employ a separate corporation as a vehicle to accomplish the purchase, merely takes the transaction another step removed from a direct purchase by the stockholders, especially where less than all of them participate in the venture.

In *Koppers Co., supra,* the taxpayer, Koppers Co., was a corporation which owned all of the stock of a subsidiary corporation, Koppers Products Co. The subsidiary had $6,050,000 in bonds outstanding in the hands of the public. The taxpayer purchased all but a few of these bonds from the various holders thereof for a total purchase price of $5,163,507.18. In order to provide part of the financing for the acquisition of the bonds, Koppers Co. borrowed $1,500,000 from the subsidiary. Shortly after this acquisition the taxpayer corporation caused the subsidiary to call the entire bond issue for redemption in accordance with its terms. The bonds thus acquired by the taxpayer were redeemed at the call price, which was slightly over $500,000 more than the taxpayer paid for the bonds. After the redemption of the bonds by the subsidiary was completed, the taxpayer caused the subsidiary to be dissolved.

The commissioner asserted that the acquisition of the bonds by the taxpayer at a discount resulted in income to the subsidiary and assessed tax against the subsidiary accordingly. This tax was then assessed against the taxpayer as transferee of the subsidiary. The taxpayer, of course, conceded recognition of gain by itself when the bonds were redeemed, but had offsetting losses for the year sufficient to cover any gain thus realized.

The Tax Court stated that the question presented was as follows (page 156):

> "The question to resolve, therefore, is whether the petitioner has in fact here brought about the evasion of tax by its subsidiary by causing a transaction, actually that of the subsidiary, to be carried out in petitioner's name and the profit thereon to be reflected as realized by it."

In deciding that no basis existed for attributing income to the subsidiary as a result of this transaction, the Tax Court said (2 T.C. at p. 157):

> "Here the character of the deal is not unusual and could as probably have occurred with a stranger. It is true that the taxpayer here was a controlled corporation. Nothing, however, was taken from it or conveyed to it over and above what would have passed between petitioner and an uncontrolled corporation in a similar transaction.
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> "This was a purchase which petitioner had a perfect right to make. It used its own funds for the purchase. It bought the bonds on the market for itself. Thereupon, as owner of the taxpayer's bonds, it was entitled to all of the rights of a bondholder, and those rights were not reduced by reason of the fact that it was also the owner of petitioner's stock."

With respect to the commissioners' contention, the Tax Court stated (2 T.C. at p. 158):

> "Respondent's counsel, on brief, makes the rather naive argument that petitioner, after it obtained the

necessary funds for purchase of the taxpayer's bonds on the market, could have loaned these funds to the taxpayer and allowed it to purchase its bonds direct. This is true, and had it voluntarily done so and been content to accept insufficient security for the loan, the taxpayer would have had an increased tax liability as a result in the exact amount of the deficiency here determined. The answer, however, to this argument is that petitioner did not do this. It was free to and did use its funds for its own purposes. It was under no obligation to so arrange its affairs and those of its subsidiary as to result in a maximum tax burden. On the other hand, it had a clear right by such a real transaction to reduce that burden. *Helvering v. Gregory,* 293 U.S. 465; *Chisholm v. Commissioner,* 79 F.2d 14; *Commissioner v. Gilmore Estate,* 130 F.2d 791; *Coca-Cola Co. v. United States,* 47 F. Supp. 109; *Commissioner v. Kolb,* 100 F.2d 920."

Koppers has been acquiesced in by the Commissioner (1943 C.B. 14). Furthermore, it has been cited with approval in a large number of subsequent cases, both by the Tax Court and by the various Circuit Courts, including this court in *Frank v. Int'l. Canadian Corp.,* (9th Cir. 1962) 308 F.2d 520, 530.

Again, the fact that a debt is purchased at a discount by the debtors' wife, and prior thereto the debtor-husband agreed to make a prepayment to her after she acquired it, does not result in a cancellation of the indebtedness. Thus, in *D. Bruce Forrester,* (1945) 4 T.C. 907, (Acq. 1945 C.B. 3), the taxpayer, an individual, owed a corporation $84,152.92. The claim had been valued in a probate proceeding at $28,759.34. Just prior to liquidation of the corporation, the corporation sold the claim to the taxpayers' wife at the appraised price. Shortly after the purchase of the note by the taxpayer's wife, the taxpayer made a payment on the note to his wife in the amount of $29,000. He had agreed to do this prior to the purchase by the wife even though, under the terms of the note, this payment was not due for a number of years. The husband did not arrange to himself purchase the debt directly from the corporation because of his belief that it would complicate his income tax problems. In holding that the taxpayer did not realize income on the difference between the total amount of the claim and the price paid for it by his wife, the Tax Court said (4 T.C. at p. 921):

> "There is evidence of record to indicate that petitioner was apprehensive of tax liability in 1938 growing out of the disposition by the corporation of its claim against him. Taxpayers are not obliged to so conduct their affairs as to incur or increase their income tax liability, and a transaction may not be disregarded because it resulted from an honest effort to reduce taxes to a minimum. Such designs must be carefully scrutinized, especially where, as here, the taxpayers' wife is concerned, to ascertain whether the transaction is real.
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> * * *
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> "Petitioner did not avoid any liability in the transaction. The result was nothing more, in substance, than a substitution of creditors. If the payee of the note does not pursue all of her remedies for payment of the note upon maturity, it will not be because of her legal inability to do so. Petitioner did not reduce his liability."

With respect to the prepayment which taxpayer made to his wife, the court said (4 T.C. at p. 921):

> "These payments are evidence of good faith."

In *San Jose Pacific Co. Ltd.*, 1939 (P.H.) B.T.A. Memo. Dec. 39-701, Para. 39,412, the members of an affiliated group of corporations acquired the obligations of one of their wholly-owned subsidiaries at a discount. The group filed consolidated returns, but the debtor-subsidiary was not included in the consolidated returns apparently because it was a public utility company. It was held that the discount did not result in income to the affiliated group.

The situation in the case at bar is far less susceptible to attack than the situations involved in the authorities above discussed. In *Koppers,* the debtor corporation was a wholly owned subsidiary, whereas in the case at bar the corporations were brother-sister corporations with a substantial diversity of stock ownership. In the case at bar the acquisition of the mortgage notes did not contemplate or involve liquidation of the indebtedness, while in *Koppers* at the very time the bonds were acquired at a discount it was admitted that the taxpayer intended to cause its subsidiary to call them for redemption as soon as the acquisition was completed. Not only that, Koppers Co. had an existing intention of immediately liquidating the debtor subsidiary.

In order to finance its acquisition of the bonds, Koppers Co. borrowed $1,500,000 from the subsidiary. Ajax financed the purchase from other sources (Admitted Facts XXVIII, XXIX, R. 93, 94). In *Forrester,* the husband made a substantial prepayment on the principal of the note shortly after the purchase thereof by his wife, pursuant to an agreement made with her prior to the purchase. In the case at bar, appellant taxpayer made a prepayment of $400,000 on the principal of the mortgage notes approximately three months after the purchase by Ajax (Admitted Fact XXIX, R. 93, 94). As an inducement to The Bank of California to make the loan to Ajax, Mr.

Bez had assured the bank that a substantial payment on the principal of the indebtedness would be made by appellant taxpayer to Ajax in the event Ajax was able to purchase the notes (Finding of Fact No. 8, R. 126). In both *Forrester* and the case at bar, it appeared to be for the best interests of the debtor that the notes be acquired by the particular purchaser (Exs. AA, BB). In *Forrester*, the court was of the opinion that this payment by the debtor husband was evidence of good faith. It is axiomatic that the position of a debtor, for better or for worse, is often dependent upon the character of his creditor, and the appellant taxpayer has good reason to assist Ajax by honoring Mr. Bez' commitment to the bank.

It is difficult to imagine a situation where the purchase of an indebtedness at a discount by stockholders of the debtor corporation would escape attribution to the debtor corporation if the purchase involved under the stipulated facts in the case at bar must be attributed to the debtor.

Taxpayers Have a Clear Right to Employ Any Legitimate Method of Conducting Their Affairs to Avoid Incurring a Tax Liability Which Might Have Resulted Had a Different Method Been Adopted.

The important principle set out above is expressed in one way or another in most of the cases discussed in Part I of this brief. However, *Arthur J. Kobacker,* (1962) 37 T.C. 882, Acq. 1964-2 C.B. 6, presents a particularly forceful application. In that case, the taxpayers, who were individuals, wanted to purchase the stock of a corporation, but did not have sufficient funds. Their tax counsel advised against borrowing the necessary balance, since this would require a declaration of dividends to provide funds to repay the indebtedness and would entail considerable income tax liability.

Consequently, after taxpayers had entered into a contract to purchase the stock, they organized a new corporation and assigned the contract to it. The corporation purchased the stock and borrowed the money to finance the balance of the price. About one year later, the new corporation was merged into the purchased corporation, and the purchased corporation assumed and paid the new corporation's debt.

The commissioner contended that the money borrowed by the new corporation to purchase the stock was in reality a loan to the taxpayers. On this basis, he asserted that the repayment of the loan by the acquired operating company constituted a constructive dividend to the taxpayers. In holding against the commissioner, the Tax Court said at page 895:

> "The method employed was not a sham or subterfuge but one petitioners had a legal right to employ to avoid the *incurrence* of tax liability which might have resulted had they personally borrowed the money, used it to buy the stock of Reiner's, and later caused Reiner's to pay such indebtedness."

Another case which is equally forceful with respect to this principle and provides some significant comparatives to the situation presented by the case at bar is *Ransom W. Chase,* 24 T.C.M. 1054, 1965 P-H T.C. Memo. 65-1153, Para 65,202. In that case, the taxpayer, a closely held corporation, was licensed to manufacture transducers under two sets of patents, one of which was an exclusive license, and the other a non-exclusive license. The patents under which taxpayer had the exclusive license were about to expire, and taxpayer feared that upon such expiration the owner of the other patents, Curtiss-Wright, would issue licenses to competitors of taxpayer.

For this reason, taxpayer entered into negotiations with Curtiss-Wright to obtain an exclusive license under these patents. Curtiss-Wright refused to grant an exclusive license, but suggested that taxpayer purchase the patents for the fixed sum of $135,000, payable $35,000 down and $25,000 in four subsequent annual installments. Taxpayer's management, for financial reasons, rejected this offer, but proposed to Curtiss-Wright that the shareholders of taxpayer, as a partnership, might be interested in purchasing the patents on the Curtiss-Wright terms. Curtiss-Wright indicated that this was agreeable, but that taxpayer would have to be a party to the agreement and, among other things, guarantee the unpaid balance of the purchase price. Thereupon, the shareholders of taxpayer formed a limited partnership to purchase the patents. The initial cash contribution to the partnership was $35,700, but under the partnership agreement, the partners agreed to contribute an additional $100,000 to the partnership over a four-year period. The percentage of shares owned by the shareholders of taxpayer and the percentage of the partnership interest of the shareholders in the partnership, as to each family group, was substantially the same.

Immediately after the formation of the partnership, Curtiss-Wright assigned the patents to the partnership, and the required three-party agreement was executed between Curtiss-Wright, the partnership and taxpayer.

Thereafter, taxpayer continued to manufacture and sell the transducer devices and paid the partnership a royalty on all sales of the patented items pursuant to a license agreement between taxpayer and the partnership. The license agreement also granted taxpayer an option to purchase the patents, but this option was never exercised. The balance of the purchase price for the patents was paid by the partnership to Curtiss-Wright in the installments specified in the agreement, and taxpayer was never called upon to pay anything under its guarantee. The patents in question were vitally necessary to taxpayer's business and virtually all of the income of the taxpayer was dependent upon use of the patents.

The court states the commissioners' position as follows (24 T.C.M. at 1068, 1965 P-H T.C. Memo. 65-1168):

> "Nor is respondent taking the position that the series of transactions and agreement which took place herein are unreal and should be disregarded as being a sham. His only contention is that the substance of the series of events should be looked at rather than the form. Once this is done, respondent contends that the only logical conclusion is that Corporation became the owner of the patents. With this we cannot agree.
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> * * *
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> "Respondents' entire case is based upon the premise of what he terms a 'tax avoidance scheme.' It is argued by respondent that if Corporation did buy the patents here involved from Curtiss-Wright, there would be no deduction for 'royalty' payments and any payments to the stockholders would be taxable as ordinary dividends. However, the creation of a partnership composed of the principal stockholders of Corporation, which then acquires the patents, gives the double benefit of a deduction to Corporation and capital gains to the partners. It is for this reason that respondent concludes that the substance of the series of transactions culminated in the purchasing of the patents by Corporation. Accordingly, respondent denies recognition to the series of trans-

> actions solely because of the tax benefit derived from the form in which they were cast. Respondent is, in effect, making motive the sole criteria for determining the legitimacy of a transaction. Needless to say, this is an erroneous position."

The court then outlines the legal principles bearing on the commissioners' argument:

> "The legal right of a taxpayer to arrange his affairs so as to decrease the amount of what would otherwise be his taxes or altogether avoid them cannot now be questioned * * * (citing cases) * * * In so arranging his affairs, a taxpayer may choose any form of doing business he desires without being required to adopt the form which results in the greatest tax * * * (citing cases) * * * The tax consequences do not depend upon the motive or purpose in entering into a transaction, * * * (Citing cases) * * * That is to say, a taxpayer's motive to avoid taxation will not establish liability unless the transaction does so regardless of the motive. * * * (citing cases) * * * Therefore, our sole inquiry is not what the purpose or motive of the taxpayer was, but 'whether what is claimed to be is in fact.' "

Having determined that the partnership was the real purchaser of the Curtiss-Wright patents, the court held that the ownership of the patents could not be attributed to the taxpayer. With respect to the vital importance of the patents to the taxpayer, the court said (24 T.C.M. at 1070, 1965 P-H T.C. Memo. 65-1170):

> "True, Corporation's business success depended upon its right to manufacture the articles covered by the Curtiss-Wright patents. While this fact might indicate that Corporation could have purchased the patents and that it may have been reasonable for it to do so, it does not show that Corporation did in fact purchase the patents."

With respect to the commissioners' contentions that the taxpayer could have and should have purchased the patents itself and that, therefore, taxpayer should be deemed to have done so, the court said (24 T.C.M. at p. 1071, 1965 P-H T.C. Memo. 65-1171):

> "While we do not think the facts support respondents' position, it is not necessary for us to decide this point. Even if we assume respondent is correct, all this requires is a closer scrutiny of the transactions to see whether the substance was in fact any different than the form of the transactions * * * (citing cases) * * * This we have done, and we are satisfied that the form of the transactions was no different than the substance. We are not concerned with why Corporation did not buy the patents but with the question of who did in fact purchase the patents * * * (citing cases) * * *
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> * * *
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> "To say that Corporation did purchase the patents because Corporation could have or because it, using hindsight, was cheaper to do so, does not show that Corporation did in fact purchase the patents. We will not recast these transactions because respondent argues an approach which is more advantageous to the revenue."

The *Chase* decision is particularly significant when certain circumstances in that case are compared with the situation in the case at bar. In *Chase*, the taxpayer corporation needed the patents, but couldn't afford to buy them. The partnership formed by the stockholders stepped in and bought them and granted the corporation a license to use them. This arrangement provided substantial tax benefits to all concerned over what would have been the case if the corporation had itself purchased the patents. The commissioner characterized the whole thing as a "tax avoidance scheme." The court points out the fallacy of the commissioner's position in that he is attempting to deny recognition to this series of transactions solely because of the tax benefit derived from the form in which they were cast. In other words, the commissioner made motive the sole criteria for determining the legitimacy of the transaction. As the Tax Court states:

"Needless to say, this is an erroneous position."

In the case at bar, the relationship of the appellant taxpayer to Ajax is far less intimate than the relationship of the corporation and the partnership in *Chase*. Another important point bearing on the case at bar is emphasized in *Chase*. This is that the fact that the corporation needed the patents and could have purchased them, and that it would have been reasonable for it to do so, does not show that the corporation did, in fact, purchase the patents. The court points out that it will not recast a transaction because the commissioner argues an approach which is more advantageous to the revenue. See also: *Golden State T. & R. Corp. v. Comm'r*, (9th Cir. 1942) 125 F.2d 641; *Guaranty Trust Co. v. U.S.*, (E.D. Wash. 1942) 44 F.Supp. 417, *aff'd*, (9th Cir. 1943) 139 F.2d 69.

If the Corporate Entity of Ajax Were to Be Disregarded, Its Corporate Activities Would Be Attributed to Its Shareholders, Not to Appellant Taxpayer.

As the stipulated facts affirm, Ajax was organized by stockholders of appellant taxpayer, not by appellant taxpayer. Appellant taxpayer had no stock interest in Ajax whatsoever, and its only relationship with Ajax was the identity of the larger part of the stockholders of each corporation. Thus, if the corporate entity of Ajax were to be disregarded, its corporate activities would be attributable only to its stockholders, not to appellant taxpayer. *Comm'r v. Montgomery*, (5th Cir. 1944) 144 F.2d

313. In that case, the taxpayer, who was an individual, had entered into five construction contracts. At a time when the construction under these contracts was partially completed, the contracts were assigned to a newly organized corporation, the stockholders of which were the taxpayers' wife and children. The taxpayer reported and paid a tax on the portion of the profits on these jobs attributable to the work completed prior to the assignment. The profit on the balance of the work was reported by the corporation. The commissioner asserted that the profits on the entire job should be attributable to the taxpayer. In ruling against the commissioner on this issue, the Circuit Court said at page 315:

> "Here, the corporation is owned primarily by stockholders other than Montgomery. It cannot be said that he and it are practically one. If we would attempt to look through the corporation we would mainly see not this taxpayer but his children."

Part II

The Section 269(a)(1) Issue

Section 269(a)(1) Cannot Apply to the Situation Here Involved Because Appellant Taxpayer Did Not Acquire Control of Ajax, Nor Did Ajax Acquire Control of Appellant Taxpayer.

Section 269(a)(1) of the Internal Revenue Code of 1954 (in the form as it existed prior to the 1963 amendment) insofar as claimed by the Government to be applicable[12], provides as follows:

> "Sec. 269. ACQUISITIONS MADE TO EVADE OR AVOID INCOME TAX
>
> "(a) In General. —If—
>
> (1) any person or persons acquire, or acquired

(12) For the full text of Section 269(a), see Appendix A, page A-2.

> on or after October 8, 1940, directly or indirectly, control of a corporation, or
>
> (2) * * * *
>
> and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit or other allowance shall not be allowed. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation."

This section applies only where a "person or persons" acquire, directly or indirectly, "control of a corporation," *and* the principal purpose for which such acquisition was made is the evasion or avoidance of Federal income tax *by* securing the benefit of a deduction, credit or other allowance which such person or corporation would not *otherwise* enjoy. The term person or persons as used in this section refers to both individuals and corporations (Section 7701(a)(1) I.R.C.). Control is defined as ownership of 50 percent of the voting power or 50 percent of the total value of the shares of the corporation.

The deductions, credits or other allowances which are disallowed by this section may be those of either the acquired corporation or of the acquiring corporation (or individual, as the case may be). *Comm'r v. British Motor Car Distributors, Ltd.*, (9th Cir. 1960) 278 F.2d 392.

However, the section cannot apply to a corporation or individual which is neither the acquired corporation or the acquiring corporation or individual. Thus, in the case at bar, unless appellant taxpayer is either an acquired corporation or the acquiring corporation, within the meaning of the section, Section 269(a)(1) cannot apply to deductions, credits or other allowances claimed by it.

The stockholders controlling appellant taxpayer also controlled Ajax, but their control of appellant taxpayer was of long standing and was clearly not acquired for any purpose relating to Ajax or the purchase of the mortgage notes. Thus, the control relationship between appellant taxpayer and its own stockholders cannot be the basis for the application of Section 269(a)(1), because the control was not acquired for the purpose proscribed by the section, and this is an essential element to the application of Section 269(a)(1).

The stockholders referred to did acquire control of Ajax in the course of the transactions here involved. However, no deduction, credit or other allowance claimed by Ajax or by said stockholders is challenged.

The only deduction, credit or other allowance which is challenged by the Government is the operating loss deduction claimed by appellant taxpayer.

Thus, unless appellant taxpayer acquired control of Ajax or Ajax acquired control of appellant taxpayer, within the meaning of the section, Section 269 (a)(1) cannot apply to the situation here involved, because acquisition of such control is an essential element to the application of the section.

As previously stated in this brief, Ajax and appellant taxpayer were brother-sister corporations. Neither of them acquired or owned any stock whatsoever in the other. Their only connection with each other was the fact that the larger part of the stock of each of them was owned by the same stockholders. These stockholders, having been in control of appellant taxpayer for a number of years, acquired control of Ajax in the manner stated in the Statement of Facts herein.

The Government asserts that this must be construed as the acquisition, indirectly, of control of Ajax by appellant taxpayer. However, it is obvious that the mere fact that two corporations are controlled by the same stockholders does not place one of them in control of the other, directly or indirectly, except in cases where attribution statutes expressly require that assumption for certain limited purposes. There is no attribution statute which applies to Section 269. The attribution rules of Section 318 are not applicable to Section 269, since they apply only to subchapter C of the Code, and Section 269 is the subchapter B. *Brick Milling Co.*, 22 T.C.M. 1603, P-H T.C. Memo, Para. 63,305.

In *Brick Milling Co.*, one of the issues was when control of a corporation was acquired within the meaning of Section 269(a)(1). Two brothers owned the controlling stock of corporation A and corporation B. On October 23, 1957, they transferred the controlling stock of corporation B to corporation A. Due to the common ownership of the stock of the two corporations by the same stockholders, it was argued that corporation B was already controlled by corporation A and, thus, corporation A did not acquire control by the receipt of the B stock. The Tax Court held that common ownership of stock by the same stockholders does not vest control of either corporation in the other within the meaning of Section 269(a)(1). In this connection, the court says (22 T.C.M. 1610):

> "* * * the attribution rules of Section 318 are inapplicable since they apply only to subchapter C of the 1954 Code, and Section 269 is in subchapter B. The Petitioner has pointed to no provisions of the Code that would attribute ownership of Sanitary stock to it so as to justify the holding that Brick Milling Company controlled Sanitary Ice prior to the time it acquired the Brick brothers' shares in 1957."

See also Mertens, *Federal Income Taxation,* (1967 rev.) §38.66, at p. 196; and *Thomas E. Snyder & Sons Co. v. Comm'r,* (7th Cir. 1961) 288 F.2d 36, applying the same rule to Section 129 of the 1939 Code.

That the acquisition of control is essential to the application of Section 269(a)(1) is established by the decision of this court in *Maxwell Hardware Co. v. Comm'r,* (9th Cir. 1965), 343 F.2d 713. In that case, Maxwell Hardware had sustained losses of $1,000,000 in the hardware business. It entered into an agreement with two partners (who theretofore had no interest in Maxwell) who were engaged in numerous real estate development activities, whereby a real estate department was established by Maxwell to develop a subdivision. The funds to finance the real estate venture were furnished by the two partners through the purchase of nonvoting preferred stock for an amount equal to about two-fifths of the value of Maxwell's common stock.

The agreement provided that the real estate venture would be continued for six years, that the partners would not sell their stock during that period, and that if the real estate department were discontinued after six years, the preferred stock would be redeemed by distribution in kind of 90 percent of the departments' assets to the preferred stockholders. A voting trust was established to restrict the control of the common stockholders for a period of five years. The voting trust agreement appointed a bank as voting trustee with unfettered authority to vote the common stock, except that it was bound to vote for two specified individuals (a bank officer and one of the common stockholders) as two of the three directors. Although the bank was unrestricted as to the third director, it was understood that one of the partners (Federighi) would be the third director. The hardware business was discontinued and the real estate business was operated at a profit.

The Tax Court found as a fact, and this court affirmed, that the primary purpose of the partners in making the deal was to offset the anticipated profits of the real estate venture against the prior losses of the hardware business.

This court points out, however, that Section 269 requires more than a proof of purpose to avoid taxes. In this connection this court says, at page 720:

> "The additional requirement is the acquisition directly or indirectly of control of a corporation, specifically, the ownership of stock possessing at least fifty percent of the voting power or at least fifty percent of the total value of shares of all classes."

With respect to the commissioners' argument that the partners acquired control indirectly through the voting trust agreement, this court said at page 721:

> "Such evidence, however, does not, in our view, justify an inference, as the Government asserts, that fifty percent voting control was thereby acquired by Beckett and Federighi. A voting trust agreement is too valuable a vehicle for the effectuation of innumerable commercial transactions to be thus

> lightly impugned; and the eagerness of the commissioner to collect taxes, a duty imposed on him by law, should not lead the courts arbitrarily to disregard established and useful forms of business relationships."

Having disposed of the specific points of law raised in the case, this court then lays down a statement of policy which we feel compelled to quote (p. 723):

> "Taxation is peculiarly a matter of statutory law, and in applying that law to the determination and computation of income and deductions, the courts do not make moral judgments. There is nothing perfidious or invidious in enjoying a statutory deduction from reportable income. It is not a matter of conscience but of statue and the determination of Congressional intent. In our opinion, Congress has quite plainly said that net operating loss deductions should be allowed unless the special circumstances interpreted within the letter and spirit of Sections 382(a) and 269 obtain. The conditions disallowing the deduction have not been established here. It is of much more importance that businessmen, accountants, lawyers and revenue agents should retain confidence that plain statutory language means what it says and what it reasonably implies than that a particular deficiency assessment should be sustained."

Appellant Taxpayer Did Not Secure the Benefit of a Deduction, Credit or Other Allowance Which It Would Not Otherwise Have Enjoyed.

In addition to the complete bar to the application of Section 269(a)(1) resulting from lack of control of Ajax by appellant taxpayer, the fact the appellant taxpayer did not secure the benefit of a deduction, credit or other allowance which it would not otherwise have enjoyed, is a second, independent bar to the application of Section 269(a)(1).

The tax avoidance attributed to appellant taxpayer in the case at bar is based on its determination not to purchase the mortgage notes. If it had purchased them, it would have realized additional income from cancellation of indebtedness and thus would have sustained additional income tax liability for the year ended March 31, 1957. By electing not to purchase the notes, this additional tax liability was simply not incurred. No deduction, credit or other allowance was involved. The purchase of the notes by Ajax did not secure to appellant taxpayer any such deduction, credit or other allowance.

However, the Government points to appellant taxpayers' operating loss deduction, asserting that this is indeed a deduction and may therefore fall within the ambit of Section 269(a)(1). In order to analyze this assertion, it must be recalled that the operating loss deduction arose from operating losses incurred by appellant taxpayer in years other than the year ended March 31, 1957 (ex. A-1). As previously stated, these operating losses have been claimed as deductions for appellant taxpayers' taxable years ended March 31, 1960, and March 31, 1961, and it is conceded that they are available as deductions in those years unless they are consumed and thus exhausted by the additional taxable income which the Government asserts appellant taxpayer has incurred from cancellation of indebtedness in the year ended March 31, 1957 (Ex. A-1, Stipulation No. IV, R. 104). It thus becomes apparent that the Government is not really attempting to deprive appellant taxpayer of the benefit of this operating loss deduction. On the contrary, it is asserting that the benefit of this deduction is to be enjoyed in the year ended March 31, 1957, rather than in the later years as claimed by appellant taxpayer. If appellant taxpayer in fact realized additional taxable income in the year ended March 31, 1957, the operating loss deduction is properly applicable against that income, and the taxpayer receives the full benefit of the deduction. If appellant taxpayer did not realize the additional taxable income in the year ended March 31, 1957, the operating loss deduction is not consumed and remains available for application against the taxable income in subsequent years. In neither case is the appellant taxpayer deprived of enjoying the benefit of a single dollar of the deduction.

This is a vastly different situation from the case where a taxpayer, having already accrued a sizable operating loss deduction and having no foreseeable way of utilizing it, enters into a transaction whereby he will be able to enjoy the benefit of such deduction that would not otherwise be available to him.

To the extent that appellant taxpayer had an intent to avoid taxes, it was to avoid *paying* a ruinous tax for its year ended March 31, 1957. Section 269(a)(1), has no bearing on the taxpayers' purpose to avoid incurring additional tax. *John F. Nutt,* (1962) 39 T.C. 231, *aff'd on another point, Nutt v. Comm'r,* (9th Cir. 1965) 351 F.2d 452.

In *Nutt,* the taxpayer, who had been a farmer since 1935, formed a corporation in 1955 and transferred to it a portion of his farmlands including a mature, but unharvested, cotton crop thereon for a consideration of $324,933, the larger part of which represented the value of the unharvested cotton. Later in the same year, he organized a second corporation to which he transferred certain farm leases, also including mature, but unharvested, cotton crops for a consideration of $97,856, the larger part of which also represented the value of the unharvested cotton. The taxpayer continued to operate the farms as an officer of the corporations much in the same manner as he had previously done as an individual. The commissioner contended, among other things, that the farm income should be allocated to the taxpayer under Section 269(a)(1). In rejecting this argument, the Tax Court said at page 250:

> "Respondent has not disallowed to petitioners any deduction, credit or other allowance but has rather increased both the income and deductions claimed by petitioners on their returns. Since respondent has not attempted to disallow to petitioners a deduction, credit, or other allowance claimed by them, Section Section 269 of the Internal Revenue Code of 1954 is by its terms inapplicable."

Furthermore, in the case at bar, appellant taxpayers' stockholders had an equally legitimate alternative open to them. They or a group of them could have bought the mortgage notes individually in which case Section 269(a)(1) could not have had any possible application. Where various alternatives are thus available, the selection of one of them does not result in obtaining a benefit which would not otherwise have been enjoyed. *Cromwell Corp.*, (1964) 43 T.C. 313.

In *Cromwell*, four individuals desired to acquire corporation A (Cornwell). To this end, they formed corporation B (Cromwell), which obtained a temporary loan of $400,000 from a bank secured by corporation A's assets and guaranteed by the individuals. With the proceeds of this loan corporation B acquired all of the corporation A stock. After the acquisition, corporation A obtained a new $400,000 bank loan, secured again by A's assets and guaranteed by the individuals. Corporation A then paid a $400,000 dividend to corporation B, and B paid off its temporary bank loan. B and A filed a consolidated return for the year involved, thus eliminating the dividend from their consolidated net income.

It was pointed out that the purchasers could have purchased the assets rather than the stock of corporation A, in which case they could have used the assets as collateral for the bank loan, and Section 269(a)(1) would not have had any possible application.

Nevertheless, the commissioner disallowed to the corporations the privilege of filing a consolidated return on authority of Section 269(a)(1) and contended that corporation B was taxable on the $400,000 dividend. The court said at page 317:

> "We rest our decision upon the ground that, irrespective of purpose, there has been no securing of a benefit which would not otherwise have been enjoyed."

The commissioner argued (as did the Government in the case at bar) that corporation B would not have been formed but for the apparent opportunity to finance the acquisition of corporation A by withdrawing its accumulated earnings without incurring the tax which would have resulted if the principals has purchased the stock and received the dividends themselves. With respect to this contention, the court said at page 322:

> "Section 269 refers to securing the benefit of a deduction, credit, or other allowance which such person would not otherwise enjoy. It does not use a

> 'but for' test of whether or not the taxpayer would secure the same benefit if the questioned 'deduction, credit, or other allowance were eliminated from the transactions. Certainly if the only change in the transactions were that Cromwell was never formed, the principals would be liable for a tax on the dividend paid to them as shareholders of Cornwell. However, it is utterly implausible that the principals would have chosen to follow such a course in acquiring Cornwell. Rather, they would have employed one of the alternative methods discussed above. We are persuaded that such alternatives were completely feasible and since the benefits sought herein would have been enjoyed, Section 269, by its very terms, is inapplicable."

CONCLUSION

It is respectfully submitted that for the foregoing reasons, and on the authorities cited, (1) appellant taxpayer did not realize taxable income from cancellation of indebtedness in its taxable year ended March 31, 1957, as a result of the transactions which are the subject of this proceeding, and (2) that Section 269(a) of the Internal Revenue Code of 1954 does not apply to the transactions which are the subject of this proceeding, and the net operating loss deductions claimed by appellant taxpayer for its taxable years ended March 31, 1960, and March 31, 1961, are not disallowed by said section; and that the judgment of the trial court should be reversed with directions to enter judgment in favor of appellant taxpayer accordingly.

Respectfully submitted,

GRAHAM, DUNN, JOHNSTON
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BRYANT R. DUNN
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Attorneys for Appellant

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with these rules.

William R. Smith
Of Attorneys for Appellant

APPENDIX A

Section 61(a) of the Internal Revenue Code of 1954

SEC. 61. GROSS INCOME DEFINED.

(a) GENERAL DEFINITION.—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;

(2) Gross income derived from business;

(3) Gains derived from dealings in property;

(4) Interest;

(5) Rents;

(6) Royalties;

(7) Dividends;

(8) Alimony and separate maintenance payments;

(9) Annuities;

(10) Income from life insurance and endowment contracts;

(11) Pensions;

(12) Income from discharge of indebtedness;

(13) Distributive share of partnership gross income;

(14) Income in respect of a decedent; and

(15) Income from an interest in an estate or trust.

Section 269(a) of the Internal Revenue Code of 1954 (Prior to 1963 Amendment)

SEC. 269. ACQUISITIONS MADE TO EVADE OR AVOID INCOME TAX.

(a) IN GENERAL.—If—

(1) any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or

(2) any corporation acquires, or acquired on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately before such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation, and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit or other allowance shall not be allowed. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation.

APPENDIX B

Table of Exhibits and Depositions

Exhibits

The following exhibits (except Exhibit 00) were identified and offered in evidence at the trial of this case by appellant and appellee jointly, and received in evidence without objection. Exhibits A through NN were identified, offered and admitted in accordance with Paragraph 7 of the Pre-Trial Order (R. 105). Exhibit 00 was identified and offered by appellee and admitted without objection (Tr. 89).

Exhibit	*Description*	*Record Transcript of Proceedings*
A-1	Notice of Deficiency (90-day letter) dated December 20, 1963, from the Commissioner of Internal Revenue to appellant taxpayer for the taxable years ended March 31, 1960, and March 31, 1961	Tr. 20
A-2	List, as of January 30, 1957, of beneficiaries under Trust Agreement dated June 27, 1950, between Sarah Harris Johnson and Seattle-First National Bank for the benefit of the former shareholders of P. E. Harris & Co.	Tr. 20
B	Minutes of Special Meeting of Board of Directors of The Ajax Company held January 30, 1957, with attachments	Tr. 20
C	Minutes of Special Meeting of the Board of Directors of The Ajax Company held February 21, 1957	Tr. 20
D	Power of Attorney dated July, 1956, from Thos. J. Bannan to Mr. Nick Bez and Mr. G. Hamilton Beasley	Tr. 20

Exhibit	Description	Record Transcript of Proceedings
E	Escrow instructions dated February 1, 1957, from The Ajax Company to the Trust Department of the Bank of California, N.A.	Tr. 20
F	Letter dated February 21, 1957, from The Ajax Company to The Bank of California, N.A.	Tr. 20
G	Letter dated February 21, 1957, from The Ajax Company to The Bank of California, N.A.	Tr. 20
H	Letter dated February 21, 1957, from The Ajax Company to Seattle-First National Bank	Tr. 20
I	Document entitled "Transfer of Assets Upon Distribution of Trust" dated February 21, 1957, with Schedule "A" attached, executed by Seattle-First National Bank, Trustee	Tr. 20
J	Document entitled "Assignment" dated February 21, 1957, with Schedule "A" attached, executed by The Ajax Company, Assignor	Tr. 20
K	Receipt dated February 21, 1957, issued by The Bank of California, N.A., to The Ajax Company	Tr. 20
L	Letter dated July 12, 1957, to The Bank of California, N.A., from Graham, Green & Dunn, Attorneys at Law, 625 Henry Building, Seattle 1, Washington, executed by Mr. James Wm. Johnston, containing a Receipt dated July 15, 1957, executed by The Bank of California, N.A.	Tr. 20
M	Promissory Note dated February 20, 1957, executed by The Ajax Company	Tr. 20
N	Letter dated March 20, 1957, from The Ajax Company to William R. Staats Com-	

Exhibit	Description	Record Transcript of Proceedings
	pany, containing a Receipt, dated March 27, 1957, executed by William R. Staats Company	Tr. 20
O	Undated letter from The Ajax Company to The Bank of California, N.A.	Tr. 20
P	Promissory Notes dated May 23, 1957, and October 2, 1957, respectively, executed by The Ajax Company and payable to the order of The Bank of California, N.A., in the sum of $192,000.00	Tr. 20
Q	Bills Receivable ledger of The Bank of California, N.A., maintained with respect to The Ajax Company	Tr. 20
R	List of stockholders of The Ajax Company, February 21, 1957	Tr. 20
S	List of stockholders of P. E. Harris Company, Inc., February 21, 1957	Tr. 20
T	Agreement dated June 11, 1957, by and between Seattle-First National Bank and The Ajax Company	Tr. 20
U	Standby Agreement dated April 21, 1958, executed by The Ajax Company and P. E. Harris Company, Inc., to Seattle-First National Bank	Tr. 20
V	Minutes of Annual Meeting of Stockholders of The Ajax Company held May 17, 1957	Tr. 20
W	Minutes of Annual Meeting of Board of Directors of The Ajax Company held May 17, 1957	Tr. 20
X	Minutes of Special Meeting of Board of Directors of The Ajax Company held January 31, 1958	Tr. 20
Y	Minutes of Annual Meeting of Stockholders of The Ajax Company held May 29, 1958	Tr. 20

Exhibit	Description	Record Transcript of Proceedings
Z	Minutes of Annual Meeting of Board of Directors of The Ajax Company held May 29, 1958	Tr. 20
AA	Minutes of Annual Stockholders Meeting of P. E. Harris Company, Inc., held May 17, 1957	Tr. 20
BB	Minutes of Annual Meeting of Board of Directors of P. E. Harris Company, Inc., held May 17, 1957	Tr. 20
CC	Minutes of Special Meeting of Board of Directors of P. E. Harris Company, Inc., held December 10, 1958	Tr. 20
DD	Minutes of Adjourned Special Meeting of Board of Directors of P. E. Harris Company, Inc., held January 14, 1959	Tr. 20
EE	Copies of letters dated January 16, 1959, from Nick Bez to Donald Royce, Fred R. Tuerk, Thos. J. Bannan, Jacques Bergues and George Darneille	Tr. 20
FF	Document entitled "Option" dated January, 1959, in favor of Nick Bez, covering common stock and promissory notes of P. E. Harris Company, Inc.	Tr. 20
GG	Letter dated March 6, 1959, from Nick Bez, The Ajax Company, P. E. Harris Company, Inc., and Peninsula Packers, to Seattle-First National Bank; List of P. E. Harris Company, Inc., stock and notes dated 3/31/50, covered by options to Nick Bez; List of The Ajax Company stock and notes dated 2/20/57, covered by options to Nick Bez; Letter of transmittal and instructions to Seattle-First National Bank; Assignment of P. E. Harris Company, Inc., stock to The Ajax Company; Assignment of P. E. Harris Company, Inc., Non-Negotiable Promis-	

Exhibit	Description	Record Transcript of Proceedings
	sory Notes to P. E. Harris Company, Inc.; Assignment of The Ajax Company stock to Nick Bez dated March, 1959; and Assignment of The Ajax Company Non-Negotiable Promissory Notes to The Ajax Company, dated March, 1959	Tr. 20
HH	Document entitled "Amendment to Partnership Agreement" dated March 4, 1959, between Calvert Corporation and Trans-Pacific Fishing & Packing Company, as partners doing business as Peninsula Packers	Tr. 20
II	Minutes of Special Stockholders Meeting of The Ajax Company held March 25, 1959	Tr. 20
JJ	Minutes of Special Meeting of Board of Directors of The Ajax Company held March 25, 1959	Tr. 20
KK	Minutes of Special Meeting of Board of Directors of The Ajax Company held June 29, 1959	Tr. 20
LL	Letter dated June 29, 1959, from The Ajax Company to The Bank of California, N.A., approved and accepted by The Bank of California, N.A. on June 29, 1959	Tr. 20
MM	Letter dated June 30, 1959, from The Ajax Company to P. E. Harris Company, Inc.	Tr. 20
NN	Document entitled "Complaint" in the Superior Court of the State of Washington for King County, No. 493805, with attachments	Tr. 20
OO	Memorandum re P. E. Harris Company, Inc., dated June 5, 1956	Tr. 86, 89
PP	Agreement dated March 23, 1950, between P. E. Harris & Co. and P. E. Harris Company, Inc.	Tr. 159, 160

Exhibit	*Description*	*Record Transcript of Proceedings*
QQ	Promissory note dated March 31, 1950, executed by P. E. Harris Company, Inc., and payable to P. E. Harris & Co. in the sum of $1,350,000.00	Tr. 159, 160
RR	Promissory note dated March 31, 1950, executed by P. E. Harris Company, Inc., and payable to P. E. Harris & Co. in the sum of $318,432.00	Tr. 159, 160
SS	List of Stockholders and unsecured note holders of P. E. Harris Company and The Ajax Company as of February 21, 1957	Tr. 162, 163
TT	Financial statement of P. E. Harris Company, Inc., for the year ended March 31, 1957	Tr. 25 (2-10-67)
UU	Financial statement of P. E. Harris Company, Inc., for the year ended March 31, 1958	Tr. 25 (2-10-67)
	Deposition of William Arthur Hinckley, with attached exhibits, taken December 7, 1966	Tr. 161, 162
	Deposition of William Arthur Hinckley, with attached exhibits, taken January 11, 1967	Tr. 161, 162
	Deposition of Herbert Magnuson taken January 11, 1967	Tr. 161, 162
	Deposition of Jacques Bergues taken December 6, 1966	Tr. 161, 162
	Deposition of Jacques Bergues taken January 10, 1967	Tr. 161, 162